



**RIGA
GRADUATE
SCHOOL OF
LAW**

Analysis of Outright Monetary Transactions and Public Sector Purchase Programmes- legality and economic reasoning

BACHELOR THESIS

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DECLARATION OF HONOUR:

I declare that this thesis is my own work, and that all references to, or quotations from, the work of others are fully and correctly cited.

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RIGA, 2019

Abstract

The main objective of this study was to establish a doctrine on how the OMT and PSPP can be compatible with the TFEU Article 123, which prohibits monetary financing of Member States by the ECB. The second and third objectives were to briefly examine what legal frameworks are practiced in other countries and assess the economic necessity of such programmes and future prospects. The research unravelled the interpretation methods used by the CJEU and established the sufficient safeguards doctrine. The doctrine has two main principles which cannot be violated in the creation of the particular safeguards, and those safeguards ultimately prevent the breach of the TFEU. Economic research made it clear that excessive indebtedness to fund massive public projects would produce hyperinflation and should be avoided. Analysis of major macroeconomic indicators and technical analysis have produced evidence of likely economic contraction in the medium term.

SUMMARY

This work will be conducted in a doctrinal-dogmatic research style with a comparative approach regarding the legality of government bond purchase programmes in the Japan, United States and the United Kingdom. This is *de lege lata* research, inductive approach will be used to establish a general doctrine regarding the legality quantitative easing programmes under Article 123 of the Treaty on the Functioning of the European Union.

The first part of the research examines the economic perspective of the issue. Explaining that the usual steering of interest rates was not working sufficiently enough to guarantee the price stability, therefore the ECB had to implement government bond purchase programmes to calm the distress, that had arisen from increasing bond spreads. These actions resulted in stabilization of EU's sovereign debt markets, at the same time 16 countries in the Union still hang around the 60% debt to GDP mark. The economic part further examines the MMT policies, which are condemned by the finance experts from the US and even proven to cause hyperinflation, if implemented. Therefore, excessive government deficits to fund large public projects are undesirable. The PSPP programme conducted in the EU is considered to be proportional and not promoting such actions. Continuing, the research examined the factors such as the flattening yield curve, business cycle theory, VIX and the technical analysis of the S&P500 to showcase the probable economic downturn in the medium term. The fact that the PSPP is not active currently, will help the ECB to deal with the next downturn more effectively since its QE abilities will not be extended.

The general rule is set in the second part of the research as a grammatical interpretation of Article 123 TFEU. It states that sovereign bond purchases by the ECB would not be allowed if the literal rule would be followed. Therefore setting up a proposition for the discovery of the complementary interpretations and the doctrine the CJEU has used to proclaim those programmes as lawful.

The Gauweiler Case was the first challenge to the ECB's monetary policy. In this Case, the Court used interpretation from the Pringle Case to interpret Article 123 by analogy. The CJEU has used historic, systematic and teleological interpretations to explain why the purchases on the secondary markets can be allowed. As it turns out, the initial drafters of the Maastricht Treaty planned that Articles 123 and 125 TFEU would prevent States from following unsound budgetary policies but did not plan for the failure of this mechanism. Therefore the Court had to use the sufficient safeguards doctrine, which follows the initial

objectives of the Treaty drafters. The initial draft, provided commentaries on the Treaty, explaining that the purchases of government bonds on the secondary markets should not be used to circumvent the meaning of Article 123 TFEU. Therefore, when such purchases are conducted, sufficient safeguards should be built into those programmes to prevent them from circumventing the meaning of Article 123 TFEU. In the later Weiss Case, the CJEU confirmed the sufficient safeguards doctrine and attached continuity to it. The research has as well analyzed the specific safeguards the ECB has implemented to ensure the bond purchases are lawful, such as the embargo period and the 33% purchase limit from one bond issue.

On the third part of the research, legal frameworks that other Central Banks have, are analyzed comparatively. All in all, purchases on the primary markets are only permissible in Japan and only with the permission of the Parliament. The ECB stands out with regard to the legal challenges it has had to fight. And comparatively, to other countries, where the scope of the Central Bank mandate is not so clear, the doctrine regarding the government bond purchases in Europe is precise. And that might help it considerably in future interventions.

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TABLE OF ACRONYMS

Outright Monetary Transactions	OMT
Public Sector Purchase Programme	PSPP
Treaty on The Functioning of the European Union	TFEU
European Central Bank	ECB
European System of Central Banks	ESCB
Quantitative Easing	QE
Gross Domestic Product	GDP
European Union	EU
Court of Justice of the European Union	CJEU
Advocate General	AG
German Constitutional Court	GCC
German Central Bank	GCB
Portugal, Italy, Greece, Spain	PIGS
Standart and poor 500 index	S&P500
Securites and Markets Programme	SMP
Volatility index	VIX
Modern Monetary Policy	MMT
Federal Reserve Bank	FED
Bank of Japan	BoJ
Bank of England	BoE
United States Dollars	USD
United States	US

INTRODUCTION

Article 123 of the Treaty on the Functioning of the European Union¹ prohibits any financing of public budgets and since debt instruments like bonds exist, the direct purchase of them is likewise prohibited. However, the purchase of the bonds in the secondary market is allowed.² The idea is that these indirect purchases happen after the market has set a fair price of the bonds, therefore avoiding the risk of the European System of Central Banks just buying up bonds from the governments at rates that possibly deviate from the market. This has resulted in the ESCB buying significant amounts of bonds at the markets from the European countries with high debt levels, therefore enhancing conditions for borrowing to some countries.

It might not take a very smart person to notice that the European Central Bank is going around the prohibition in the Article 123 TFEU and conducts monetary financing of the Member States, even though the Court of Justice of the European Union has deliberately made it legal. In 2014 a petition was filed by Peter Gauweiler and 37000 other Germans including politicians, academics, economists and journalists in German Constitutional Court.³ The Court asked for a preliminary ruling and asked two important questions in its reference to the CJEU, second one being- whether the ECB measure is compatible with the TFEU Article 123(1) which prohibits monetary financing by the ECB.⁴

The Court and the Advocate Generals have rejected the objections and declared quantitative easing policies to be legal. Court has reasoned its opinion in 2 recent cases, one mentioned above happened in 2014 and another one in 2017, there are 2 subsequent AG opinions of the cases that all together will be used to understand the CJEU's interpretation of the law. Thereby the paper aims to answer two **research questions**:

How can the Outright Monetary Transactions and the Public Sector Purchase Programmes be compatible with the TFEU Article 123 'no bailout clause' and what legal frameworks are in practice in the United States and Japan compared to the European Union?

What is the economic necessity for such quantitative easing programmes and the future

¹ Law Treaty on the Functioning of the European Union, Article 123 (Consolidated version 2012), OJ C 326, 26.10.2012. Available on: eur-lex.europa.eu/legalcontent/EN/TXT/?uri=celex%3A12012E%2FTXT.

² Geiger, Khan and Markus Kotzur. *European Union Treaties*, A Commentary. Oxford: Hart publishing, 2015, page 589.

³ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400.

⁴ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 10 (b).

perspective?

In this research, I will be comparing legal frameworks for quantitative easing between the United States, Japan, and Europe. It is probable that Japan and the United States could provide some meaningful examples of how their legal systems handle quantitative easing as in Europe some parties object to its lawfulness. As this research will be interdisciplinary an economic necessity for such asset purchase programmes will be examined. Extraordinary economic circumstances had taken place, where the ECB had tried to revive the economy with all the measures available to it but had failed. The author argues that after the 2008 economic crisis we should have been implementing regulatory changes in the financial industry as well as making changes towards more sustainable economic development.⁵ The argument being that the aggressive lending path chosen by the ECB through quantitative easing, might not have been the right way towards sustainable development in the future. Through the Public Sector Purchase programme, 2,2 trillion Euros have been lent to the Member States or other government agencies. Central banks all around the world have been using this economic stimulation strategy, with Japan leading the way, many scholars⁶ refer to it as the 'unconventional monetary experiment',⁷ experiment, because no one has seen consequences to it yet. This Quantitative easing enables governments to run deficits and still not default, since in the European Union the ECB has taken everyone's back, by supporting the monetary system and essentially bolstering the bond market of Member States. The author would argue that such indebted policies are not the most sustainable path in the long run. Therefore I take the side which would argue that Public Sector Purchase Programmes and Outright Monetary Transactions programmes fall foul of Article 123 of the TFEU and should not be continued, or at least be reviewed and reformed. When looking through the long term prism, the analysis made in this research will be relevant when the next correction comes and ECB lands at crossroads, where it either has to design new quantitative easing programme or seek other-more frugal policies. Notable historian- Will Durant has said: "A nation is born stoic, and dies epicurean..."⁸ In this context, stoic would mean taking the losses and recovering and becoming more efficient rather than the epicurean way of amassing more debt to sustain

⁵ Rene Smits, *Internationally Monetary and Financial Law, Legislative Measures To Support Financial Market Stability: The German Example And Its European Contrast*, Oxford University Press (2010), page 328.

⁶ Kevin Logan, HSBC Chief Economist, "The Fed Launched QE Nine Years Ago - These Four Charts Show Its Impact", accessed on: www.cnbc.com/2017/11/24/the-fed-launched-qe-nine-years-ago--these-four-charts-show-its-impact.html.

⁷ Juselius, Mikael and Borio, Claudio E.V. and Disyatat, Piti and Drehmann, Mathias, "Monetary Policy, the Financial Cycle and Ultralow Interest Rates", August 10, 2016, Bank of Finland Research Discussion Paper No. 24/2016, accessed on SSRN: ssrn.com/abstract=2823454.

⁸ Will Durant, Quote accessed April 15, 2019, accessed on: www.goodreads.com/quotes/7474738-a-nation-is-born-stoic-and-dies-epicurean-at-its.

our present comforts. The legal doctrine serves three main goals: description, prescription, and justification. In the description part of the work existing law will be described, in parallel with economic circumstances. The prescription part of the research will search for solutions to the issue and the justification part will justify the existing law. The legal doctrine is a living system that aims to achieve 2 aims at the same time- constancy and change in the development of the law,⁹ therefore this research will aim to do- just that. Broadly recognized scholar- Catherine Barnard holds the opinion that the EU is a highly dynamic establishment and its norms are in a process of continuous development, therefore this research will analyze views of the Court and the Scholars in the background of the economy

1. THE ISSUE FROM AN ECONOMIC PERSPECTIVE

1.1 Crisis, interest rates and debt to GDP

The source of a fiscal crisis in the European Union can be traced back to the 2008 economic contraction. The crisis in the financial sector caused a serious debt problem within the Eurozone. Whenever Economic cycle turns downwards- the European central bank and any other Central bank in the world would lower the interest rates, since it is their primary tool to increase the money supply and spending, because with lower interest rates money becomes cheaper. Cheaper money boosts household consumption, therefore boosting inflation. At the time of the crisis, this tool just stopped being effective, hence even negative interest rates got implemented. The European System of Central Banks main tasks according to the Treaty- are to maintain price stability and safeguard the value of the Euro.¹⁰ Price stability can be understood as inflation that is between one and two %.

Let's see a graph of European Unions inflation and ECBs interest rates in the last decade:

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
EU (28) Inflation(%) ¹¹	3.7	1	2.1	3.1	2.6	1.5	0.6	0.1	0.2	1.7	1.9
ECBs interest	3	1.75	2	1.75	1.5	0.75	0.3	0.3	0.25	0.25	0.25

⁹ Jan M. Smits, "What Is Legal Doctrine? On The Aims And Methods Of Legal-Dogmatic Research", Maastricht European Private Law Institute Working Paper No. 2015/06.

¹⁰ "ECB mission", accessed on: www.ecb.europa.eu/ecb/orga/escb/ecb-mission/html/index.en.html.

¹¹ Eurostat, "consumer prices- inflation", accessed on: www.ec.europa.eu/eurostat/statistics-explained/index.php?title=Consumerprices-inflation&oldid=404313.

rates(marginal lending facility) ¹²											
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The table showcases the aforementioned logic. Interest rate alteration can be a very powerful tool to steer the economic system, but at times of exceptional circumstances, it can be exhausted and become less efficient in the medium and short term.¹³ It can be seen that the interest rates have been lowered since 2008 achieving new lows almost every year. Inflation particularly decreased in the 2012-2016 period while the ECB lowered the interest rates as low as 0.1%. It can be seen that in the medium short term, this monetary policy tool has been ineffective, therefore the ESCB had to shoot from their bazooka of Quantitative Easing, in order to increase the government, household and corporate spending. The fact that the interest rates were not effective in the medium and short term does not mean that they have been ineffective in the long run, and it can be so that rather than being effective, they have inflated the market with cheap money and even strengthened this bull run with the Quantitative Easing, that got implemented to counteract the deflationary trends. Carl Icahn, the United States billionaire- has addressed the theory of modern monetary policy as a dangerous thing, He expressed his view in a recent interview:

We don't want to hit a wall that you can't recover from. Once you get into an inflationary spiral, it's very difficult to get out of it -- and therein lies the danger.¹⁴

Warren Buffett has also joined the camp that despises increasing government deficits to support excessive current spending, He said that:

We do not need to get in the danger zones and we do not know precisely where they are.¹⁵

These danger zones can be understood as excessive deficits that can give rise to inflationary spirals. Similar views have been expressed by Charlie Munger as well.¹⁶ Another representative of the higher echelons of finance- Ray Dalio has expressed that that shift to MMT is inevitable because in Dalio's view the central banks will have to enact

¹² "Key ECB interest rates", accessed on:

www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html.

¹³ Ray Dalio, "How The Economic Machine Works", (2013), accessed on:

www.youtube.com/watch?v=PHe0bXAIuk0.

¹⁴ Ichan Rips MMT, "Warns It Could Lead to an 'inflationary spiral' ", accessed on:

www.bloomberg.com/news/articles/2019-04-30/icahn-rips-mmt-warns-it-could-lead-to-an-inflationary-spiral.

¹⁵ "Buffett Joins Scorn of Modern Monetary Theory and 'Danger Zones' ", accessed on:

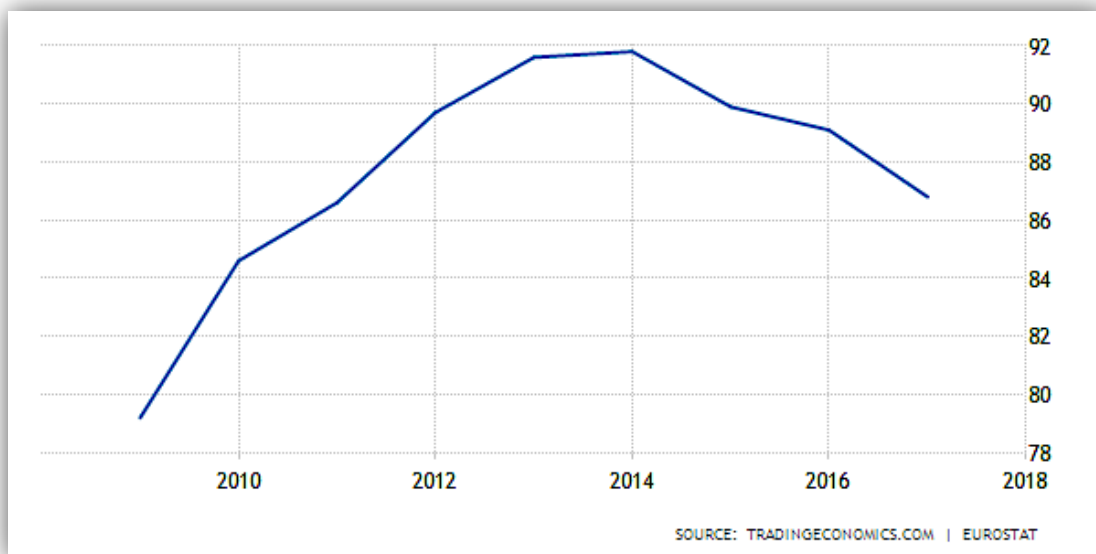
www.bloomberg.com/news/articles/2019-03-15/buffett-no-fan-of-modern-monetary-theory-with-its-danger-zones.

¹⁶ Charlie Munger: "Be Afraid When a Democracy Thinks It Can Print Money To Solve All Its Problems", accessed on: www.cnn.com/2019/05/06/charlie-munger-be-afraid-when-a-democracy-thinks-it-can-print-money-to-solve-all-its-problems.html.

these policies in order to pull the economy out of the next slump.¹⁷ This argument can be considered hypothetical since it aims to project the future and father of monetary policy- John Maynard Keynes has famously said: In the long run we are all dead...¹⁸

1.1.1 Debt and the GDP

According to the Stability and Growth Pact that is in place to ensure that the Member States pursue sound public finances,¹⁹ the European Union Member states should not amass debt that would cross the 60% debt to the GDP mark. Neither should they cross the 3% government deficit line.²⁰ Following, there are 15 countries in the Eurozone with the debt to GDP going over 60% mark.²¹ At the same time, the European System of Central Banks has implemented policies that have provided liquidity and demand for bonds coming from excessively indebted euro area members. It is important to note that currently, the overall EU government debt to gross domestic product rate has been slightly decreasing each year, after the peak in 2014.



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¹⁷ Ray Dalio Says the Coming Of Modern Monetary Theory Favored By Far Left Is 'inevitable', accessed on: www.cnbc.com/2019/05/02/ray-dalio-says-the-coming-of-modern-monetary-theory-favored-by-far-left-is-inevitable.html.

¹⁸ John Maynard Keynes, *The Tract on Monetary Reform*, London, (1923).

¹⁹ European Commission, "Stability and Growth Pact", accessed on: www.ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact_en.

²⁰ Ibid.

²¹ "Debt to GDP in %", accessed on: tradingeconomics.com/country-list/government-debt-to-gdp?continent=europeraph.

²² Eurostat, "Average debt to GDP in EU", accessed on: tradingeconomics.com/euro-area/government-debt-to-gdp.

When assessing the geographical scope of the debt issue, an important distinction can be noticed about the countries located on the coast of the Mediterranean sea. Portugal, Italy, Greece, and Spain-all have a debt to GDP ratio exceeding the 97% mark.²³ When comparing, the countries located in the northern side of Europe have much lower debt levels, except for the Belgium that has 103% debt to GDP. Estonia leads by example with debt to GDP not exceeding 8%.²⁴

1.1.2 Guidance for the future and the effectiveness of the PSPP

The Vice-President of the European Commission Valdis Dombrovskis, responsible for the Euro and Social Dialogue, also in charge of the Financial Stability, Financial Services, and Capital Markets Union, said:

The European economy is experiencing its seventh consecutive year of economic expansion. Yet growth is slowing down. Maintaining momentum into the future will require a high level of competitiveness, as well as continued upward convergence. To unlock the full growth potential of our economies, we need structural reforms. We also need well-targeted investment to bolster productivity growth across Europe.²⁵

Note that the high level of competitiveness and the targeted investment to bolster productivity is mentioned as the primary objectives. And the reasoning on that follows the low level of effectiveness that the government spending has. Namely, the governments get partially funded by debt which is bonds, that the ESCB buys through the OMT and the PSPP. And the effect of the government expenditure on the GDP is calculated as a fiscal multiplier. The Latvian Central Bank has examined the Keynesian multiplier of an average European Union State, and in the last 2 years, it has been 0.7. This means that every Euro the government spends- adds 70 cents to the GDP in the next 2 years. That is not satisfying since the desired ratio would be over 1 ideally towards 2, where each Euro spent gets multiplied in the economy 2 times. Research has shown that the fiscal multiplier accelerates by 0.7-0.9 at times of economic downturn compared to the bull run times.²⁶ Therefore it has been a smart decision to halt the active stage of QE purchases as of December 2018.

²³ Ibid.

²⁴ Ibid.

²⁵ European Commission, press release, “*European Semester Winter Package: assessing Member States' progress on economic and social priorities*”, (2019). Accessed on 5th of April 2019 at: www.europa.eu/rapid/press-release_IP-19-1389_en.htm.

²⁶ Gechert, Sebastian and Ansgar Rannenberg, “Which Fiscal Multipliers Are Regime-Dependent? A Meta-regression Analysis”, *Journal of Economic Surveys*, (2018), 32(4): 1160–1182.

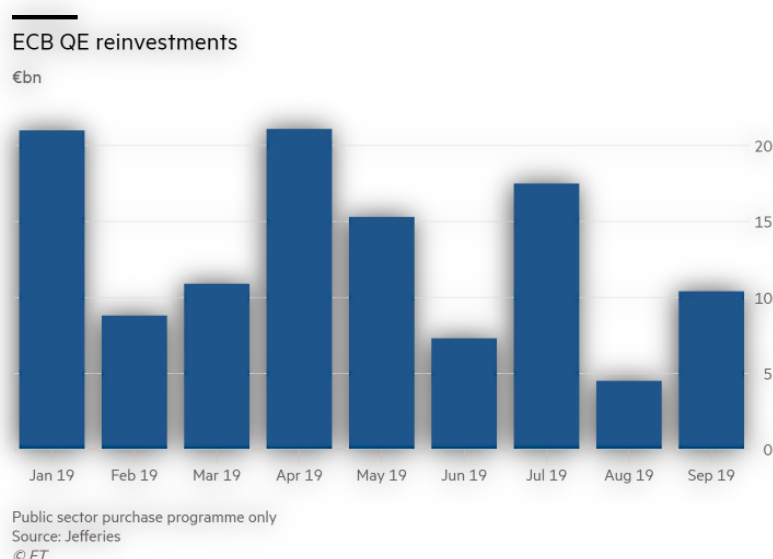
1.2 What are OMT and PSPP programmes and what economic consequences they have had?

These programmes are essentially monetary policy instruments that concern the ECB and the European System of Central Banks, in their supervision over the Euro. ESCB is composed of the ECB and national central banks and they are the main agents carrying out the ESCBs policy.²⁷

Outright monetary transactions is a term used to describe the European Central banks monetary policy measures, that has taken place since the July 26th, 2012 when ECBs president Mario Draghi in His speech proclaimed that He would do anything necessary to preserve the Euro.²⁸ By this, He meant, that he would resort to ECB buying bonds from member states and even large corporate players. This was the day when the OMT was introduced.

1.2.1 The current stage of the asset purchase programmes and the business cycle

Asset purchase programmes of the ESCB have finished their active stage as of December 2018. Now they are in a stage where the money coming in from mature securities gets reinvested in the markets.²⁹



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²⁷ Gareth Davies, *European Union Internal Market Law-Second Edition*, Cavendish Publishing, United Kingdom, 2003, p. 94.

²⁸ Mario Draghi, speech: "Global investment conference", London, 26th of July, 2012, accessed on: www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html.

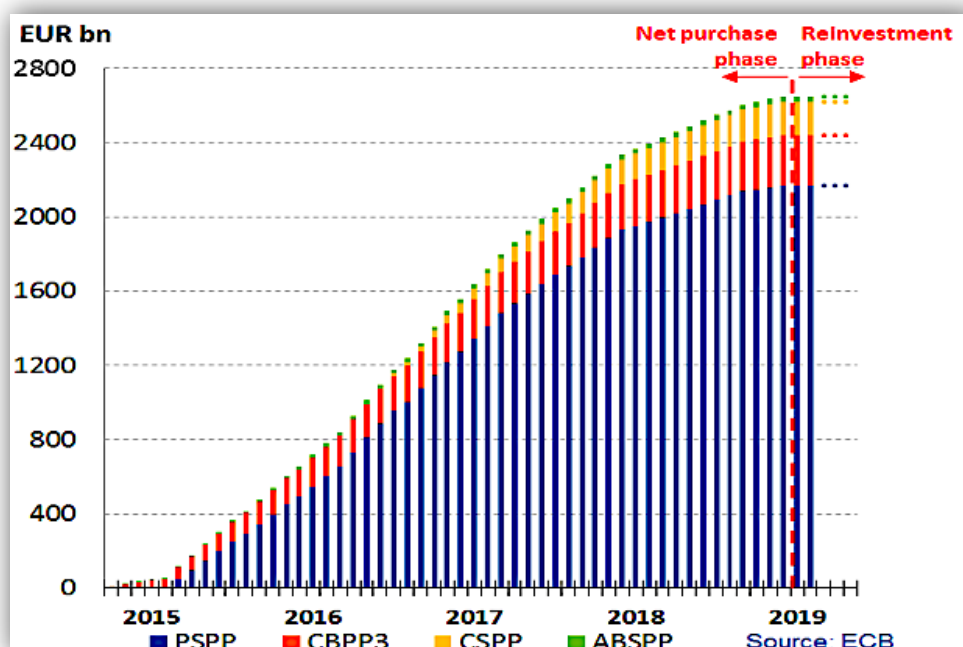
²⁹ ECB, "Asset purchase programmes", accessed on: www.ecb.europa.eu/mopo/implement/omt/html/index.en.html.

³⁰ "Capital Key Risks and Italy Dilemma for the ECB.", "ECB QE reinvestments", accessed on: www.ft.com/content/bf97360a-d14d-11e8-a9f2-7574db66bcd5.

Even though these programmes are not in the active state currently, it is still relevant to examine, if it is lawful to purchase public sector bonds, or how the Court has made it lawful. It is great news that the European economy does not need any increased stimulation by the ESCB currently, as all the major macroeconomic data is solid- inflation (1-2%), satisfactory employment, stable GDP growth of states. The usual macroeconomic Business cycle is 6 to 8 years, the last major recession happened in 2008, there have been over 10 years since the last contraction already.³¹ The argument is, that we have not seen a recession for a long time and when recessionary times come, the ESCB will most likely have to stimulate the economy by injections of money, again. And therefore those monetary stimulations should still be bound by the Treaty and the previous case law doctrine, which we will be analyzing.

The magnitude of the PSPP and technical analysis of the S&P500

One reason why some parties believe that monetary financing should be restricted is that it creates a fertile soil for unfit economies to borrow. Higher indebtedness when the next recession comes might cause the World Economy to tumble. The backbone for these claims is the unconventional monetary policy that has created so much debt as never before in history.



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³¹ Will Kenton. "Business Cycle", accessed on: www.investopedia.com/terms/b/businesscycle.asp.

³² ECB, "APP cumulative net purchases, by programme", accessed on: www.ecb.europa.eu/mopo/implement/omt/html/index.en.html.

The ESCB has lent 2,2 trillion throughout the PSPP programme, thus boosting the government expenditure in the aggregate demand equation. The equation is the following: $\text{Aggregate demand} = \text{Consumer Spending} + \text{Private Investment} + \text{Government Spending} + \text{Net Exports}$. It can be concluded that aggregate demand has been boosted by 2,2 trillion during the 5 years of the active stage of the PSPP programme.

The doctrine of the Keynesian multiplier suggests that the aggregate demand which is boosted by government spending, results in income for the enterprises and citizens, thus creating an effect that can even double the impact of government spending. It can as well be, that the government spending on infrastructure results in profits for the construction companies, that have a cautious outlook on the economy, so they decide to keep profits to themselves. That can result in the multiplier being below 1. The research has shown that the multiplier accelerates by 0.7-0.9 at the times of economic downturn.³³ It can be observed as a positive factor, that the PSPP is now at a passive reinvestment state. That can result in better monetary policy efficiency when the next downturn comes. If according to the Latvian Bank, the average multiplier of an EU State is 0.7,³⁴ then at recessionary times, it could reach 1.4-1.6 marks, that can be considered as a good efficiency of monetary stimulation.

Recent research has explained what would happen if excessive deficits were implemented to finance huge public projects. Thomas Palley has chosen an example of free Medicare for all, free college education and the green new deal, which would result in 11.3% net increase in the GDP, the final increase in the GDP after the Keynesian multiplier would be 17%. The excess demand generated by these injections at 2% unemployment rate, according to the Phillips curve³⁵ would result in spiking inflation since there would not be enough workers to do all the jobs. According to the Phillips curve, once the economy gets to full employment- the free lunch disappears and additional injections will generate inflation, if not offset by increased taxation. All the methods to amortize the deficit are unreasonable, for example- amortization of such a deficit through the taxes would require the federal tax rate to increase by 78%.³⁶

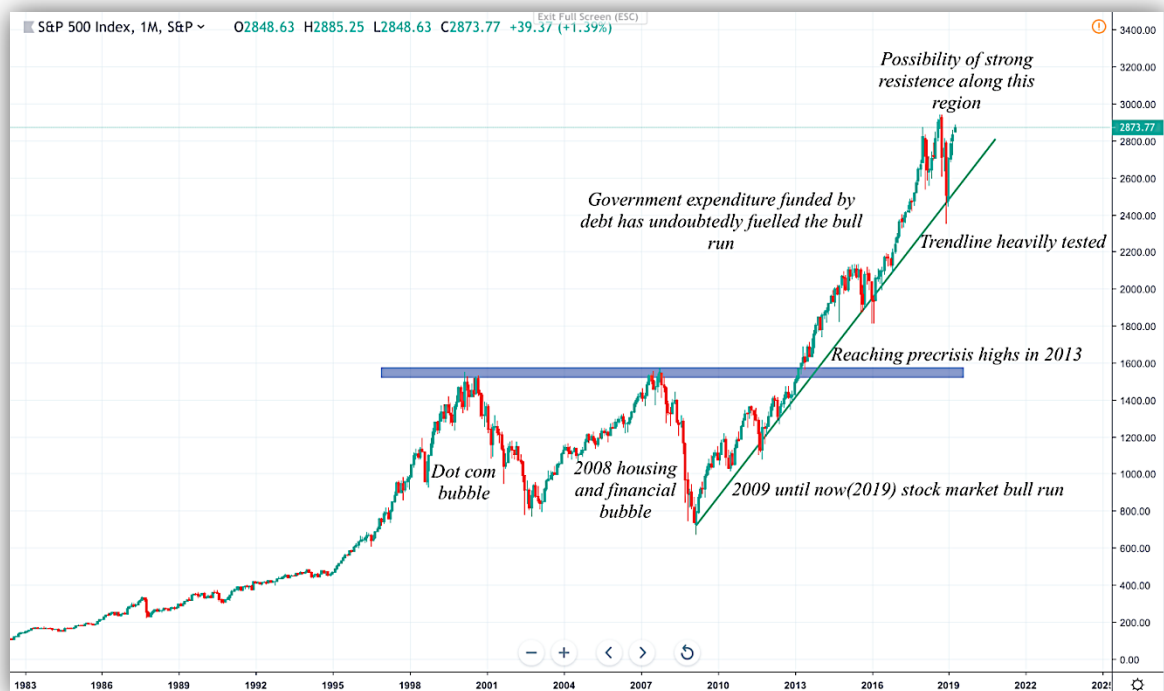
³³ Gechert, Sebastian and Rannenberg, "Which Fiscal Multipliers Are Regime-Dependent? A Meta-regression Analysis", p. 1160–1182.

³⁴ Latvian Bank economist- Oleg Tkacev, "Consequences of expansive fiscal policies in the Eurozone", 5th of April, 2019.

³⁵ Reviewed by Jim Chappelaw, "Phillips curve", last edited: 1st of May, 2019, accessed on: www.investopedia.com/terms/p/phillipscurve.asp.

³⁶ Thomas Palley, "Macroeconomics VS Modern Market Theory: Some unpleasant Keynesian arithmetic", April, 2019, page 6, accessed on: www.postkeynesian.net/downloads/working-papers/PKWP1910.pdf?fbclid=IwAR3F9yy0MRwNKOpInCKXb-o2DjIaUgzDI6YsMz06zMgO-OWVNEhRQ2w85o.

These research findings tie well together with the arguments put forward in the 1.1 chapter by practitioners of the finance. Both- Warren Buffett and Carl Ichan believe that excessive deficits to finance public projects should be avoided since they are likely to result in uncontrollable inflation and financial crisis. Warren explained that we do not know where the limits lie, but the recent study put forward by Palley, has shown, that financing of these projects ends up in unbearable deficit and unfeasible price levels since there are not enough workers to provide the labour. Palley shows us, that the materialization of these projects by using debt is unrealistic and it reaches well beyond the limits mentioned by Buffett and Icahn.



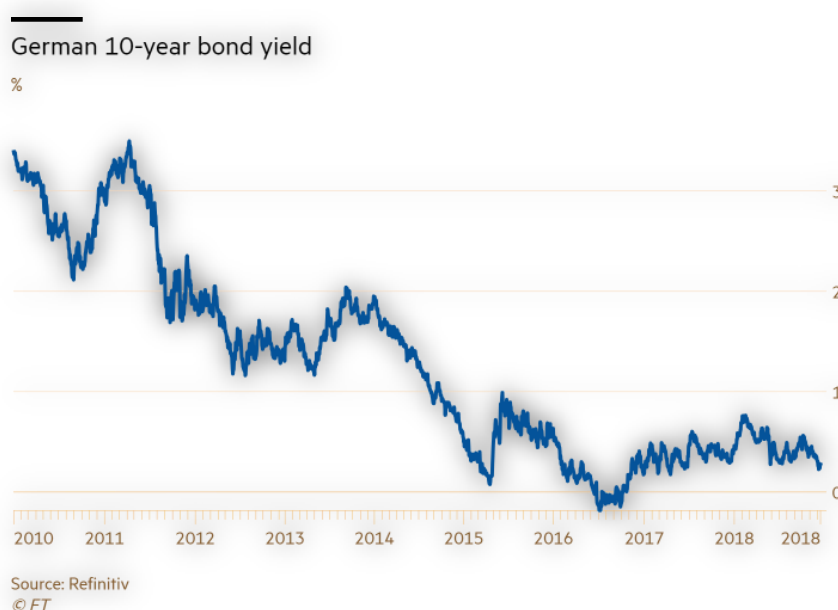
The United States economy is the largest in the world with a hefty 25% share of the global GDP.³⁷ Therefore its Standard and Poor 500 index, that represents the 500 leading companies in America is representative of how the world economy is doing.³⁸ In the graph, we can see that the index reached its pre-crisis highs in the wake of 2013 and kept rallying until the 2900 point mark at the end of 2018. We have experienced a bull run for ten years and the price has currently found a strong resistance just under the 3000 price point. This resistance level gets supported by a large number of short sellers, that expect the business cycle to finally decline. This run with no doubt has been financed partially by the QE.

³⁷ “International Monetary Fund outlook October 2018, for year 2019 and 2023”, accessed on: statisticstimes.com/economy/projected-world-gdp-ranking.php.

³⁸ Chad Langager, “How is the value of the S&P500 calculated?”, accessed on: www.investopedia.com/ask/answers/05/sp500calculation.asp.

1.2.2 Effects on the bond market and spreads

Research has found, that asset purchase programmes has resulted in a reduction of sovereign bond spreads. The initial Securities and Markets programme has had the most notable effect on the spreads, we can see from the graph that since 2010 when the SMP was announced, the German bonds dropped by almost 3% in the yield. The OMT announcement resulted in a significant bond spread reduction in the periphery- PIGS countries. The most recent PSPP programme has not resulted in a significant reduction in bond spreads for most countries with the exception of Ireland.³⁹ However, we can not underestimate its effectiveness to keep the rates stable.



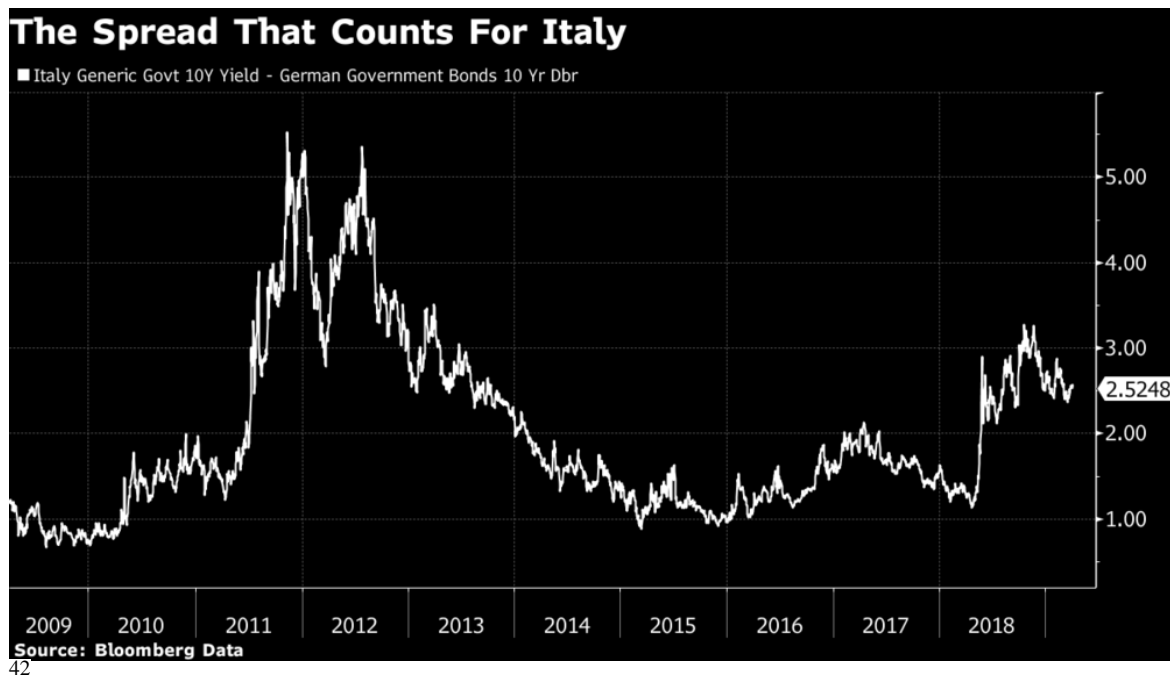
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Before the OMT the bond spreads had become unsustainable between Germany and the periphery. The unsustainability comes when the German bond, the year 2015 rate is approximately 0% whilst at the same time, Portugal's yield went across the 2.4% mark.⁴¹ Both countries have the same currency, but at the same time- investments through this currency- has yields so distant from each other. The most recent spread concerns have arisen after the latest election in Italy.

³⁹ Gibran Watfe, "The Impact of the ECB's Asset Purchase Programmes on Sovereign Bond Spreads in the Euro Area", abstract, 2015.

⁴⁰ Allen, Kate. "Investors Grapple with Europe's Darkening Economy", January 25, 2019, accessed on: www.ft.com/content/b4c0761e-1feb-11e9-b2f7-97e4dbd3580d.

⁴¹ Portugal 10 year bond yield, accessed on 2 May, 2019, www.investing.com/rates-bonds/portugal-10-year-bond-yield.



The wider the spreads, the tougher the situation for the Italian government, since their borrowing costs rise significantly. This graph shows the spike in the spreads between Italian and German bonds that occurred after the elections. The Markets do not like the populists that have distorted the coalition, the markets tell that information through the bond spreads- they are risky. The bond spread of the PIGS countries tend to move in positive correlation, but what is particularly alarming is the fact, that even the Spains and Italian bonds have increased the spread from 0.5% before the election, to 1,5% now.⁴³ That signifies the particular risk Italy carries.

The most notable effect on the bond spreads has been left by the SMP and OMT programmes, they have helped to even out the spreads. The PSPP has helped to keep the spreads within reasonable borders, with the recent exception of Italy.

1.2.3 Flattening yield curve for bonds and CBOE volatility index

Flattening yield curve of debt securities (bonds) means that the investors are less willing to invest in longer-term bonds, therefore the return on the longer term bonds gets closer to the yields that the short term bonds have. Consequently, the yield curve becomes flatter. United States yield curve was at its flattest territory in 10 years, at the end of 2018.⁴⁴ The

⁴² John Authers, "Italy, the EU and Bond Markets Are Set to Collide", bloomberg terminal, accessed on: www.bloomberg.com/opinion/articles/2019-04-04/italy-the-eu-and-bond-markets-are-set-to-collide-ju2459kk.

⁴³ Ibid.

⁴⁴ Benoît Cœuré, Speech in Financial Times European Financial forum: "What yield curves are telling us", Dublin January 31, 2018, accessed on: www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180131.en.html.

yield curve has been considered as a solid indicator for when investors do not believe in the long run strength of the economy. The yield curve complements the business cycle, as a signal for a contraction.

On the other hand, there is the VIX, which represents the risk, fear and stress pertinent to the markets for the next 30 days.⁴⁵ This index spikes particularly, when there is fear in the markets and the index remains stable, when the investors are confident of the future. In the chart, we can see the spike experienced in the 2008 recession and it spiked again around 2018 Christmas time, but for now, the index is stable and it tells us, that there is no current fear amongst investors in the short term.



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Flattening yield curve and the business cycle theory can be considered as fundamental indicators, which signal possible contraction in the medium term. But these factors are contradicted by the short term indicator- VIX. It can be concluded, that there are still strong arguments for the upcoming recession, but not currently in the short term- according to the VIX.

1.3 Inference of the economic perspective

The 2008 crisis gave birth to the sovereign debt crisis of 2011 in the European Union. One of the main tools ECB and any other central bank around the globe has- is interest rates to affect the monetary policy. In the EU, the lowering of interest rates was not working well

⁴⁵ Justin Kuepper, "CBOE volatility index definition", April 9, 2019, accessed on: www.investopedia.com/terms/v/vix.asp.

⁴⁶ CBOE VIX index, accessed at on: www.tradingview.com/symbols/TVC-VIX/.

on its own, so the ECB implemented a couple of APPs. These programmes have contributed to the debt problem many European countries have, in particular- the PIGS countries and Greece. On the other hand, these programmes have contributed to stable and narrow spreads in the EU bond market, therefore allowing the indebted countries to sustain and manage the liability section of their balance sheets. The overall magnitude of the APPs is ~2.7 trillion Euros. That can be considered reasonable if take into account that that is a period of over 7 years, and EUs annual GDP is ~ 19 trillion USD. The Triumvirate of the United States finance world- Warren Buffett, Charlie Munger and Carl Icahn all believe that excessive debts and deficits should be avoided (MMT), and for the most part, the EU countries stay on the safe side. Ray Dalio holds the view that the shift to MMT is inevitable. And research by Palley has shown the inflationary danger zones that such policies entail.

The policy measures by the central banks have worked, we have almost full employment (in EU and US) and we have arrived at stable inflation. Even though 15 countries in the EU still float around 60% debt to GDP ratio and despite Italy, the financial situation could be described as stable. Another question arises, whether the EU can sustain its debts if another recession would to come. As concluded in the last chapter- flattening yield curve plus the business cycle theory, act as bearish fundamental factors, that investors take into account. There is a complementary bearish technical indication as well, such as the resistance line at the 2900 point region for the S&P500, the worlds largest index has difficulties to breach this region. That means two things, the investors are not willing to buy more stocks at this price level and many are selling their stocks around the 2900 region since they are not sure for future prospects. The VIX, of course, acts as a neutral indicator, in this case, not signalling any stress currently, but it must be kept in mind that this index can move rapidly as it is seen of 2008 crisis when the index rose from 15.9% to 95% value in two months time. Markets can run in a bull run for a decade or more, but the selloffs are much steeper and faster since it is considered that fear is a stronger emotion than greed. Over 6 years built stock market value was crushed in 1 year- in the 2008 economic crisis. Therefore, bear market times usually have a faster effect and the consequences of that have to be mitigated by Central Bank monetary policy measures.

The financial fitness of the European Union can be considered as sound, but following the economic analysis- we are close to a downturn. Therefore, the law analysis that will be conducted regarding ECBs policies pertinent to Article 123 TFEU is ever so important. Because, with each contraction, the ECB has to find new ways, to balance out the economy

and those measures will include asset purchases.

2. CASE LAW ANALYSIS

2.1.1 The general rule

The reason for the introduction of such rule is that the monetary financing of the Member States by the European Central Bank is prohibited, therefore such actions would violate the Treaty on the Functioning of the European Union Article 123. In its clear application, the rule would mean- that whenever ECB finances any of the Member States through bond purchases, it falls inconsistent with the European Union law.

ECB finances member state by loans (bonds) → Inconsistent with the EU law

However, if the Court of Justice would apply this rule that results from a literal interpretation of the Treaty- most of the asset purchase programmes would fall foul. Therefore, monetary financing/lending, bailouts of the Member States would not be possible. In our case, there are many parties⁴⁷ in Germany and other countries that would support this rule as it is generally laid down. On the contrary, the view of the ECB and the Court of Justice would differ as it has allowed this general rule to be violated, laying out the Courts practice that goes around this rule, and indirectly violates it. The Article 123 tells us that overdraft facilities or any other type of credit facilities with the ESCB in favour of any public governance bodies in the European Union shall be prohibited as should the direct purchase from them by the ESCB.⁴⁸ This research suggests that the purchases of Eurozone member Bonds conducted by the ESCB under the various asset purchase programmes might fall within the scope of Article 123 TFEU because bond essentially is a debt product. The issuer bears a liability that he will have to repay in the future with a principal, whereas the bondholder is a lender that has the right to collect the debt at a certain time, with interest.

The proposition of this research is that the Court has deviated from this rule in its two judgements regarding the interpretation of Article 123, therefore we aim to examine how such departure has been justified by the Court and what rationale has Advocate Generales expressed in their opinions. As well as what interpretation methods have the CJEU

⁴⁷ Johnston, Andrew and Trevor Pugh, "The Law and Economics of Quantitative Easing." *SSRN Electronic Journal*, 2014, doi: 10.2139/ssrn.2463160, p. 25.

⁴⁸ Law Treaty on the Functioning of the European Union, Article 123, (Consolidated version 2012), OJ C 326, 26.10.2012. Available on: eur-lex.europa.eu/legalcontent/EN/TXT/?uri=celex%3A12012E%2FTXT. Accessed: April 15, 2019.

implemented.

2.1.2 Interpretation methods utilized by the CJEU

The CJEU has been practising multiple interpretation methods, the usual starting point is the grammatical interpretation, or in other words- the wording of the law. Systemic interpretation looks at the functions of the law and the interrelationship between the different levels of legislation. Teleological interpretation examines the Treaty with respect to its main objectives.⁴⁹ Whereas the historical interpretation seeks to understand the historical objective of the legislator. There is no absolute hierarchy between the interpretation methods. The CJEU combines all the methods and uses them side by side.⁵⁰ Even though, the wording of the provision is the starting point, it must be complemented by other methods.⁵¹ In the path of the research we will look at the interpretation methods the CJEU has implemented in order to trump the grammatical general rule- we have set in the chapter above.

2.1.3 Pringle Judgement and its relevance to Article 123 TFEU

Various measures were adopted by the European Union to combat the debt crisis around the year 2011. Those measures seemingly violated the TFEU Articles that deal with the fiscal discipline and no bailout rule, therefore those measures became subject to the Judicial review.⁵² After extensive review, the CJEU proclaimed them being legal and the doctrine discovered in the Pringle case, has been used by the CJEU to interpret the law in the Cases pertinent to the QE. The CJEU has interpreted Article 123 regarding the European Stability Mechanism, but this interpretation is still held relevant in more recent Cases, in particular interpretation of Article 123 has been made in paragraphs 123-132.⁵³

In the Pringle Case paragraph 132, the CJEU states that the Article 123, which prohibits the Member States from granting 'overdraft facilities or any other type of credit facility' uses wording which is stricter than the wording used in the Article 125.⁵⁴ When the comparison

⁴⁹ Judgment of 6 October 1982, Srl CILFIT and Lanificio di Gavardo SpA v Ministry of Health, C-283/81, ECLI:EU:C:1982:335, paragraph 20.

⁵⁰ Karl Riesenhuber, *European Legal Methodology*, Cambridge: Intersentia Ltd, 2017, p. 165.

⁵¹ Judgment of 16 December 1960, Jean-E. Humblet v Belgian State, C-6/60, ECLI:EU:C:1960:48, "wording alone is not enough".

⁵² Sideek M Seyad, "A legal analysis of ECB's OMT program to combat the debt crisis", *Journal of International Banking Law and Regulation*, (2015), available on: Westlaw.uk.

⁵³ Judgment of the 27 November 2012, Thomas Pringle v Government of Ireland and Others, C-370/12, ECLI:EU:C:2012:756, paragraphs 123-132.

⁵⁴ Judgment of the 27 November 2012, Thomas Pringle v Government of Ireland and Others, C-370/12, ECLI:EU:C:2012:756, paragraph 132.

is made, this becomes clear, Article 125 talks about the Union not having to be liable over the Member States commitments. Further, Article 125 TFEU tells- that the Union should not be liable or assume any debts or commitments of the central governments, but without the prejudice for mutual financial guarantees for a specific project. If analogy would be applied, the difference in the wording of the Article 125 compared to the Article 123- supports the view that the prohibition mentioned there, does not prohibit 'any financial assistance whatever to a Member State'.⁵⁵ Due to the analogic interpretation, this view could be transcended to Article 123, therefore interpreting it as less strict.

Therefore this sets the doctrine of the Pringle Case, where the Court believes that the prohibition of monetary financing or other overdraft facilities in the Article 123 TFEU is similar to the prohibition to assume commitments of the Member States by the Union in the Article 125. And because these both Articles carry similar yet slightly different purpose, the CJEU seems to interpret that the slightly looser attitude towards monetary assistance in the Article 125 might support the view that such assistance is permitted and lawful even under the Article 123 TFEU, in certain conditions. Article 125 is a comprehensive bailout prohibition, and the group of entities covered by both of the Articles should be identical.⁵⁶

2.2 Defining the questions regarding Peter Gauweiler Case 62/14

The request for a preliminary ruling concerns the validity of the ECBs Governing Councils decisions made on the September 6th, 2012. This request considers various technical features of the OMT programme in the secondary bond markets, as well as the interpretation of the TFEU Articles 123, 119, and 127. This request includes interpretation of the ECBs and the ESCBs Protocol number 4, Articles 17 to 24.

Numerous groups of individuals, along with a group supported by 11,000 signatories brought actions concerning the OMT programme and its implementation before the German Constitutional Court.

The request itself has been made in an environment where various German constitutional bodies have had disputes whether the German Central Bank should participate in the newly announced OMT. Request concerns the failure of the German Federal Government and the

⁵⁵ Ibid.

⁵⁶ Geiger, Khan and Markus Kotzur. *European Union Treaties, A Commentary*. Oxford: Hart publishing, 2015, page 591.

Lower House of Federal Parliament to act according to the new decisions.

The historic moment happened during the minutes of the 340th meeting of the Governing Council of the ECB on 5th and 6th September of 2012, where the Council approved the main parameters of the Outright Monetary Transactions. Applicants of the main proceedings submitted that the OMT decisions constitute an ultra vires act, namely that the ECB has exceeded its mandate and infringed the Article 123 TFEU and that those decisions encroach the principle of democracy found in the German Basic law and therefore diminish German constitutional identity.

Regarding this analysis of the Courts Judgement, the main emphasis will be put on the preliminary questions regarding Article 123 and the mandate of the ECB, since the scope of the mandate is inseparable from the issues regarding the Article 123. The mandate would concern the scope of the actions the ECB can take and the argument that Article 123 is violated consequently would mean that mandate is exceeded. To answer the research question the main attention will be paid to the matters in this Case related especially to Article 123. It is relevant to mention that both clusters of questions are the latter halves of the first and the second questions asked by the German Constitutional Court in the pertinent Cases. This separation is done for the purposes of narrowing down the scope of the research since both latter halves of questions are concerned with Article 123. Therefore the questions we will analyze, requested by the Constitutional Court of Germany to the CJEU for a preliminary ruling are:

Is the decision of the Governing Council of the ECB of 6 September 2012 on Technical features of Outright Monetary Transactions incompatible with the prohibition of monetary financing enshrined in Article 123 TFEU?

Is compatibility with Article 123 TFEU precluded in particular by the fact that the decision of the Governing Council of the ECB of 6 September 2012:

1. does not provide for quantitative limits for government bond purchases (volume)?
2. does not provide for a time gap between the issue of government bonds on the primary market and their purchase by the European System of Central Banks (ESCB) on the secondary market (market pricing)?
3. allows all purchased government bonds to be held to maturity (interference with market logic)?
4. does not contain any specific requirements for the credit standing of the government bonds to be purchased (default risk)?
5. provides for the same treatment of the ESCB as private or other holders of government bonds (debt cut)?⁵⁷

⁵⁷ Judgment of 16 June 2015, *Peter Gauweiler and Others v Deutscher Bundestag*, C-62/14, ECLI:EU:C:2015:400, paragraph 10, q. 1, part b).

The second question that falls within the scope of the research and is requested by the German Constitutional Court is:

Having regard to the prohibition of monetary financing, is Article 123 TFEU to be interpreted as permitting the Eurosystem, alternatively or cumulatively

1. to purchase government bonds without quantitative limits (volume)?
2. to purchase government bonds without a minimum time gap from their issue on the primary market (market pricing)?
3. to hold all purchased government bonds to maturity (interference with market logic)?
4. to purchase government bonds without minimum credit standing requirements (default risk)?
5. to accept the same treatment of the ESCB as private and other holders of government bonds (debt cut)?
6. to influence pricing, by communicating the intention to purchase or otherwise, coinciding with the issue of government bonds by Member States of the euro area (encouragement to purchase newly issued bonds)?⁵⁸

It must be mentioned, that the OMT programme was never launched because the mere announcement of this programme was sufficient to calm the markets. Both clusters of the questions asked are different in a way that the first cluster asks whether the ECB's decision is incompatible with the Article 123 and therefore the compatibility is especially endangered by the questions that are asked. Whereas the second cluster asks- if the prohibition of monetary financing is to be interpreted in a way to permit all the actions asked in the questions. Therefore, the first question deals with the compatibility and the second one deals with interpretation.

2.3 Analysis of the answers provided regarding the Peter Gauweiler Case 62/14

2.3.1 The volume of the programme concern answered

In this chapter, we will analyze the answers given by the CJEU in parallel with the AG opinion that was issued before the ruling, as well as the opinions of scholars pertinent to the Case. Questions in both instances are of similar wording and have similar subject matter. The answer to the first question, that concerns compatibility, can be partially found in the 82nd paragraph of the Case, where Court states that the wording of the press release makes it clear that the OMT programme is permitted only so far, as it is necessary to achieve objectives set by the programme and the purchases will stop when the objectives

⁵⁸ Judgment of 16 June 2015, *Peter Gauweiler and Others v Deutscher Bundestag*, C-62/14, ECLI:EU:C:2015:400, paragraph 10, question 2, part b).

of the monetary policy are achieved.⁵⁹ Earlier, the Court argued that the economic circumstances at the time of the press release were such that would justify the OMT as being appropriate to achieve the price stability objective.⁶⁰ Further, the Court states that the OMT announcement has been sufficient to calm the markets, so even 2 years after the announcement, the OMT has not been implemented.⁶¹ In paragraph 88 CJEU comes up with a reasoning that a programme whose volume is restricted would weaken its efficiency.⁶² Continuing of quantitative limits, Mario Draghi considers the OMT as being the second leg to the already existing European Financial Stability mechanisms,⁶³ therefore the OMT would mostly target countries currently undergoing assistance by the EFSM. Complimentary, the CJEU believes, that this would narrow the scope of countries the OMT can support and therefore explain that the volume of purchases is not unrestricted in reality.⁶⁴ Yet another argument by the CJEU, states that the disruption caused by the problems in certain bond markets needed to be targeted accordingly, buying bonds selectively from the affected States, to dissipate the disruption, and prevent the programme from being needlessly expanded in all directions.⁶⁵ The CJEU considers that such programme does not breach the principle of proportionality since its scope is restricted.

2.3.2 Compatibility with Article 123 TFEU and the Pringle doctrine

Starting from paragraph 93,⁶⁶ the CJEU brings in the Pringle Doctrine that we examined earlier and will expand on now. The CJEU does so in order to prove the OMT being compatible with Article 123(1) TFEU. Article 123 itself, maintains that any overdraft facilities or any other credit facility within the ESCB and ECB are prohibited, as well as purchases directly from the Member States of their debt instruments. Thereinafter any such assistance should be prohibited, even on the secondary markets, this is the view held by the GCC as well. To this, the CJEU in the Gauweiler Case, paragraph 95 answers that indeed the ESCB is not allowed to purchase bonds on the primary market, but that the Article 123

⁵⁹ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 82.

⁶⁰ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 80.

⁶¹ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 84.

⁶² Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 88.

⁶³ Mario Draghi, *“Introductionary statement of the press release”*, Frankfurt, 6th of September 2012, answer number 5, accessed on: www.ecb.europa.eu/press/pressconf/2012/html/is120906.en.html.

⁶⁴ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 86.

⁶⁵ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 89.

⁶⁶ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400.

TFEU does not preclude purchases on the secondary markets. In this paragraph, the CJEU refers to the Pringle Case paragraph 133, which explains that wording in Article 125 is less strict than the wording of 123 TFEU, thereafter giving a hint that this less strict meaning could be transposed by analogy, which is legal interpretation method. Following the lead from this analogy, the Court uses systemic interpretation and complements it by Article 18.1 of the Protocol on the ESCB and ECB, which states that in order to achieve its task of price stability it can purchase outright monetary instruments, such as bonds.⁶⁷

However, the Court further retreats by stating that the ESCB does not have the mandate to purchase public sector bonds under circumstances, which would mean that its actions carry equivalent consequences to the purchases made on the primary markets.⁶⁸ Drawing parallels with the Pringle Case, the CJEU has applied the teleological interpretation method that deals with the initial objectives of the law and therefore historic interpretation as well. It is seen from the preparatory work of the Maastricht Treaty that the aim of the Article 123 TFEU is to ensure that the Member States always follow sound budgetary policy, by not allowing monetary financing of budgetary deficits that lead to excessive indebtedness or otherwise- unsustainable debt.

2.3.3 Teleological and Historic interpretation by the CJEU of Articles 123 and 125 TFEU.

It is exceptionally surprising to find the historic definitions and guidelines for the application of now Article 123 and 125 TFEU, where the Council regulation states that:

..., purchases made on the secondary market must not be used to circumvent the objectives of that Article.⁶⁹

It is vividly seen, that initial aim of Article 123 TFEU was to make sure that States conduct sound and prudent finances. And even the initial source of Article 123 states that purchases on the secondary markets should not be used as a way to go around the objectives which are enshrined in the Article. Commentary on the EU Treaty book, tells us about Articles 123 and 125 TFEU from historical interpretation, where the initial objective of the Articles was to ensure fiscal independence and accordingly bond rates should increase for countries with higher deficits, because by market logic- they are riskier.⁷⁰ Rates should be lower for financially fitter countries, therefore this system should result in countries being self-

⁶⁷ Protocol On The Statute Of The European System OF Central Banks And Of The European Central Bank, “*Open Market and Credit operations*”, Article 18.

⁶⁸ Judgment of 16 June 2015, *Peter Gauweiler and Others v Deutscher Bundestag*, C-62/14, ECLI:EU:C:2015:400, paragraph 97.

⁶⁹ Council Regulation (EC) No 3603/93, December 13th, 1993, No L 332/1.

⁷⁰ Geiger, Khan and Kotzur, *European Union Treaties*, p. 591.

disciplined. But not everything went as initially planned since the fiscal crisis which unravelled. Authors of the Maastricht Treaty thought that Article 125 would prevent countries from defaulting, by inducing discipline, but they did not plan for the failure of this mechanism.⁷¹ It can be concluded, that this failure has parallelly increased the tensions regarding Article 123 TFEU since the ESCB has had to implement bond-buying programmes, that walk along the borderline of not breaching the Article 123 TFEU. If a liberal interpretation would be implemented, regarding Article 123, the ECB would be left disabled during the financial crisis. The right interpretation seems one that would only allow bond buying when such activities are necessary to ensure the survival of the Euro currency.⁷² This conditionality has been numerously mentioned by the CJEU as well. The ECB further defends the legality of the OMT programme, by referring to the events that endangered the Euro in the summer of 2012. Rumours were spreading amongst investors, resulting in a spike in interest rates paid to certain Member State bonds. This fragmentation of the debt markets was preventing proper transmission of the signals the ECB sends out usually.⁷³ And consequently, the ECB had to take measures within the limits of its competence, to guard the currency.

2.3.4 Sufficient safeguards to prevent the breach

AG Cruz Villalon, in his opinion on this Case, expressed that when the EU decides to purchase public sector bonds then sufficient safeguards should be built into those programmes to ensure they do not breach the prohibition on monetary financing in Article 123(1) TFEU.⁷⁴ He explains that completely prohibiting purchases on the secondary markets would deprive the ESCB of an efficient and essential monetary policy tool.⁷⁵ But when those purchases would be made, strong frameworks should be built in, to ensure that those purchases do not circumvent the prohibition enshrined in Article 123 TFEU. The CJEU next explains that it is not considering purchases made under the OMT programme as such, that would amount to a measure granting financial assistance.

AG Cruz Villalon takes the view, that Article 123(1) not only prohibits purchases on the primary markets but prohibits purchases on secondary markets as well. Only allowing

⁷¹ Geiger, Khan and Markus Kotzur. *European Union Treaties*, A Commentary. Oxford: Hart publishing, 2015, p. 592.

⁷² Steve Peers, *Clash of the Judicial Titans: "Will the Euro Survive?"*, February 2014, EU Law Analysis 9, available at: eulawanalysis.blogspot.com/2014/02/clash-of-judicial-titans-will-euro.html.

⁷³ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, paragraph 104.

⁷⁴ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, paragraph 227.

⁷⁵ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, paragraph 223.

purchases on the secondary markets, when they do not circumvent prohibitions mentioned in Article 123(1) TFEU. In fact, the Court has answered the questions referred to it by the GCC by referring to safeguards built into the programme that are indeed conveniently analyzed in the AGs opinion. Cruz Villalon tells his readers that doubts expressed by the GCC are based on a particular interpretation of the press release. The ECB rejected that GCCs interpretation, basing its rejection on strong arguments. In the ECBs view, the point of the technical features built in the OMT programme act like a pack of guarantees intended to prevent a breach of Article 123 TFEU.⁷⁶ When talking about default risk asked in one of the questions, the GCC believes that amassing securities on a scale like the OMT, may expose the ECB to default risk and transpose the liability to the Member States. AG argues, that according to the ECB, this programme is implemented to prevent irrational actions of the markets in the future, not amass huge debts, that would result in a default. Therefore the AG Cruz Villalon considers default risk in this case not being contrary to Article 123 TFEU.⁷⁷

2.3.5 Concerns about holding the bonds to maturity and time gap between purchases

Further, when addressing the issue of holding the bonds to maturity, the GCC believes, that holding the bonds to maturity may distort the usual price formation mechanism. To this, the ECB answers that it has not mentioned anywhere in the press release, that the bonds would be held to maturity. The ECBs arguments are considered conclusive by the AG, because the previous programmes in the past have followed such framework and the OMT will buy only bonds with maturity one to three years, thus further limiting the exposure.⁷⁸ The CJEU, in this case, expressed, that the ECB reserves the right to sell the bonds at any minute, therefore ruling out the issue of holding to maturity.⁷⁹ The Court believes that holding to maturity does depend on the decisions of the ECB, and the ECB well has the discretion to hold the bonds to the maturity, if that is needed to achieve price stability.⁸⁰

The GCC next submits that time of the purchase, must be examined. Since, purchases in

⁷⁶ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, paragraph 231.

⁷⁷ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, paragraph 240-241.

⁷⁸ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, paragraph 246.

⁷⁹ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 117.

⁸⁰ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 118.

the secondary markets can happen, literally milliseconds after they have been bought by the primary buyer. AG submits, that this is a real concern, but it is not valid in this case, because the purchases will be subjected to an embargo period, that will allow for the price to form properly. AG held, that in order for the OMT to be lawful, it must be implemented in such a way that allows the market price to form.⁸¹

2.3.6 Credit standing assessment and conclusion of the Courts Judgement

Almost lastly, the CJEU addresses the question by the GCC, that there would be no credit assessment of the States before bonds would be purchased from them. The CJEU, states that the governments whose bonds would be purchased, would need to be compliant with the structural adjustment programmes in the place and that would require them to be sufficiently financially fit.⁸²

Finally, the GCC points out, that announcement of the OMT might act as a magnet of investors, since they would feel that the ECB holding certain bonds, makes the ECB a lender of last resort, that might reduce the risk on the investment. The ECB and the Commission answer that this assessment has been based on false premises since the ECB does not plan to make announcements of which purchases it will buy because that could undermine the efficiency of the programme.⁸³ The CJEU believes that the guarantees built into the programme are sufficient to ensure that the OMT programme is compliant with Article 123 TFEU. AG as well considers the OMT lawful, provided that actual market prices subjected assets have formed properly. Therefore, the timing of the programme implementation should be proper, allowing the prices to form.⁸⁴ In the light of the abovementioned rationale, the Court has interpreted the law as permitting such- OMT programme.⁸⁵

2.3.7 German Constitutional Courts ruling and Conclusions of the chapter

The GCC received these answers to their preliminary request, and the German Constitutional Court had to provide a judgement about the constitutionality complaint

⁸¹ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, paragraph 254.

⁸² Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 120.

⁸³ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, paragraph 257.

⁸⁴ Opinion of 14 January 2015, by Advocate General Cruz Villalon, C-62/14, ECLI:EU:C:2015:7, conclusion.

⁸⁵ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 128.

brought before it. On 21st of June 2016, Case⁸⁶ the GCC issued a decision in which the main principles from the CJEU decision in Gauweiler Case,⁸⁷ were put in action. The GCC described the principles in this manner:

The German Constitutional Court held that German Central Bank should only take part in implementation of the PSPP if:

purchases of sovereign bonds are not announced,
the volume of the purchases is limited from the outset,
there is a minimum period between the issuing of the government bonds and their purchase by the ESCB that is defined from the outset and prevents the issuing conditions from being distorted,
only government bonds of Member States are purchased that have bond market access enabling the funding of such bonds,
purchased bonds are held until maturity only in exceptional cases, and
purchases are restricted or ceased and purchased bonds are remarketed should continuing the intervention become unnecessary.⁸⁸

Given the GCCs previous stance, I believe that this GCCs judgement is most reflective of the furthest boundaries the CJEU went to proclaim the OMT compatible with Article 123 TFEU. The given judgement, in my opinion, reflects all the answers given in the preliminary ruling which are embodied in this instruction from the German Constitutional Court to the German Central Bank.

In conclusion, the Article 123 TFEU would not be compatible with the EU law, if there were not sufficient safeguards built in the programme. This is clear, because the doctrine when the authors drafted the Maastricht Treaty, specifically included the clause that purchases on the secondary markets should not be used to circumvent the prohibition in the Article 123 TFEU. It is understandable, that the times have changed and the idea that Articles 123 and 125 would incentivize States to pursue sound finances, has failed. The drafters of the Maastricht Treaty did not plan for such an outcome, where the Member States have pursued unsound financial practices. Thereinafter, the EU bureaucracy has had to deal with the failure of the mechanism and deal with the monetary financing prohibition in order to find a middle ground. The middle ground they have found is allowing purchases of government debts to be carried out on the secondary markets with strict requirements,

⁸⁶ German Constitutional Court, Case No 2 BvR 2728/13, 2 BvE 13/13, 2 BvR 2731/13, 2 BvR 2730/13, 2 BvR 2729/13.

⁸⁷ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400.

⁸⁸ Johan Schweigl, Part 4-Local Finance Problems in the Light of European Union Law, *Monetary Financing Ban In The EU Law*, Publications Of The Masaryk University- theoretical series, edition Scientia File No. 516, page 599.

the main one being- that the market price would be allowed to form on the bonds subjected to purchase.

2.4 Defining the questions regarding Heinrich Weiss Case 493/17

The request for a preliminary ruling relates to repeated concerns by several groups of individuals that have brought various constitutional actions before the GCC. These actions concern numerous decisions by the ECB and participation of the GCB in the implementation process of those decisions. In this Case, similarly as in the Gauweiler Case, the applicants believe that decisions of the ECB amount to ultra vires act. Relevantly to this research, applicants maintain that ECBs decisions infringe Article 123 TFEU and similarly as in Gauweiler Case they believe that those decisions infringe the principle of democracy and undermine the German constitutional identity. The GCC found significant indications, that the way PSPP is carried out, was violating monetary financing ban.⁸⁹ The GCC believed that the specifics of the purchases were announced in a manner creating certainty about the bond purchases. As well, there is no verification possible of whether the embargo period is honoured, before the sale on the primary market and resale on the secondary markets. Thirdly, the bonds purchased under PSPP are usually held to maturity and that also made GCC and applicants in the main proceeding suspicious.⁹⁰ Since the GCCs Constitutional ruling in Gauweiler Case specifically noted, that bonds would be held to maturity only in exceptional circumstances.

In Gauweiler Case, the GCC doubted a press release. Differently, from Gauweiler case, the GCC here states that, if the decision 2015/774 exceeds the mandate or infringes Article 123 TFEU, it must uphold the various actions brought by Heinrich Weiss and others. The GCC further states that the same would apply, if the rules on the sharing of losses introduced by the decision 2015/774 affect the budgetary powers of the Federal Parliament. Following the explained circumstances, the GCC decided to refer the following questions to the CJEU for a preliminary ruling:

⁸⁹ Johan Schweigl, part 4, “Local Finance Problems in the Light of European Union Law, Monetary Financing Ban In The EU Law”, *Publications Of The Masaryk University- theoretical series, edition Scientia File No. 516*, page 600.

⁹⁰ Ibid.

Does Decision 2015/774 as amended by Decision 2016/702 or the method of its implementation, infringe Article 123(1) TFEU?

1. Does it infringe Article 123(1) TFEU in particular if in the course of the public sector asset purchase programme (PSPP),
2. details of the purchases are communicated in a way that creates de facto certainty on the markets that the Eurosystem will purchase part of the bonds to be issued by the Member States?
3. even after the event no details are given about compliance with minimum periods between the issue of a debt instrument on the primary market and its purchase on the secondary market, with the result that a review by the courts is not possible in that regard?
4. all bonds purchased are not resold but held until maturity and thus withdrawn from the market?⁹¹

The second question is:

Does the Decision referred to in [the first question] then infringe Article 123 TFEU in any event if, in view of changes in conditions on the financial markets, in particular as a result of a shortage of bonds available for purchase, its continued implementation requires a continual loosening of the originally agreed purchase rules and [if] the restrictions laid down in the case-law of the Court of Justice for a bond purchase programme, such as the PSPP, lose their effect?⁹²

To respect the scope of this research we skip the third and fourth questions with the fifth question being again relevant:

Does the unlimited sharing of risks between the national central banks of the Eurosystem that may be provided for under the Decision referred to in [the first question], in the event of the non-repayment of bonds of the central governments and of equivalent issuers, infringe Article 123 and Article 125 TFEU and Article 4(2) TEU, if as a result it may be necessary for national central banks to be recapitalised using budget funds?⁹³

Advocate General Wathelet expressed in His opinion, that there are unclarities pertinent to the subject Decision 2015/774 that the plaintiffs are questioning. Namely, the GCC inquires the CJEU to rule on the validity of the Decision 2015/774 and GCC states that the Decision 2015/774 is amended by following 2015/2101, 2016/702 and 2016/1041 Decisions. The AG expresses that Decision 2016/1041 is indeed based on the 2015/774, but it did not amend it. Wathelet clarifies that the Decision 2015/774 has been amended by the Decision 2015/2464 and by Decision 2017/100 and therefore they should be taken into account when answering the questions. Considering all the above mentioned, AG Wathelet and the European Commission holds the view that the validity of the Decision 2015/774

⁹¹ Judgment of 11 December 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 16.

⁹² Ibid.

⁹³ Ibid.

should be assessed in the version that was in force when the request for a preliminary ruling was made.⁹⁴ Another important factor is that the AG has considered the fifth question inadmissible, because of its hypothetical nature and insufficient proof to substantiate the question.⁹⁵

2.5 Analysis of the answers provided regarding the Heinrich Weiss Case 493/17

This chapter is going to analyze the answers to the questions requested by the GCC to the CJEU. The answers to these questions given will be analyzed to finalize the doctrine regarding the QE Court Cases in the EU for now. And understand what differences the Weiss Case has, compared to the previous Gauweiler Case. It can be noticed, that the GCC learned its lesson from the OMT Case and the scholarly criticism it received, thus seeking the CJEU's reference in a more genuine manner this time.⁹⁶

The first major difference could be that the Weiss Case concerns technical decision on the implementation of the PSPP programme, whereas Gauweiler Case concerned press release. The second major difference is that PSPP programme had already been implemented for 3 years at the time of the preliminary request, whereas the OMT programme was never active. Scope of the bond maturity is much wider, as PSPP is including bonds with maturity from 1 to 30 years, whilst in OMT maximum maturity was 1-3 years.

2.5.1 Advocate Generals opinion and continuation of sufficient safeguards doctrine regarding subquestions 1, 2 and 3

When the AG Wathelet assessed the first two questions, He firstly provided the analytical framework established in the Gauweiler Case, namely the sufficient safeguards doctrine. Despite, the differences, both programmes are ultimately purchasing government bonds on the secondary markets, therefore the ESCB does not have the authority to conduct purchases where its action would have an equivalent effect to the purchase on the primary markets. So, the potential purchasers of government bonds can not know for certain, that those bonds will be purchased by the ESCB.⁹⁷ This is a preventive clause to prevent

⁹⁴ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 30-32.

⁹⁵ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 45-46.

⁹⁶ Andrej Lang, "B. National Courts Ultra vires review of the ECB's policy of quantitative easing: An analysis of the German Constitutional Court's preliminary reference order in the PSPP case", (2018), 55 *Common Market Law Review*, Issue 3, p. 933.

⁹⁷ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 97.

purchasers of bonds being direct intermediaries for the ESCB. On the second hand of the sufficient safeguards doctrine- is a clause that prevents the government purchases to be of such nature to lessen the impetus of the Member States to follow sound budgetary policy.⁹⁸ By taking paragraphs 102 and 115 of Gauweiler Case, AG Wathelet has further contributed to the doctrine, with remarks on both limits. Following the 2 limits set previously, when the ESCB buys bonds on the secondary market, sufficient safeguards must be built in the intervention in order to ensure- that the intervention does not fall foul of the Article 123(1) TFEU and the same time- limits the impact the ECBs programme has on the impetus to follow sound public finances.⁹⁹

There is a lack of certainty amongst the Member States, whether the PSPP offers sufficient guarantees to prevent a breach of the Article 123 TFEU. The majority of Member States believe, the PSPP offer sufficient guarantees, with the exception of the applicants in the main proceedings. AG Wathelet shares the view the majority, that the safeguards provided are sufficient.¹⁰⁰ Firstly, the Governing Council of the ECB is responsible for the scope, start and suspension of the programme and that is not a minor thing. AG further explains that it is clear from the minutes of the Governing Council, that the PSPP is continuously adjusted and assessed, within the limits that are necessary to achieve the ECBs main objective of price stability. Therefore, Wathelet believes that is a major factor contributing to compliance with the significant safeguards doctrine.¹⁰¹

The second argument of the AG seems quite odd. Wathelet explains, that the PSSP is one of the four sub-programmes of the APP, and the purchase of government bonds under the PSSP is subsidiary to the other programmes. I would argue, that the PSPP is not subsidiary to the other programmes with respect to its size, it is rather the mother of the QE in the European Union as it contributes to more than 80% of the overall purchase volume of bonds.¹⁰² It is rather hard to understand what the AG meant by classifying the PSPP as subsidiary to the other programmes, as it is the largest programme in volume.

Thirdly, AG notes, that there is an absence of selectivity of bonds that will be purchased. In the OMT programme, the purchases were made in a selective manner, in the PSPP the

⁹⁸ Judgment of 16 June 2015, *Peter Gauweiler and Others v Deutscher Bundestag*, C-62/14, ECLI:EU:C:2015:400, paragraph 109.

⁹⁹ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 50-51.

¹⁰⁰ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 54.

¹⁰¹ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 55.

¹⁰² Ibid.

purchases are representing all the Member States and are distributed according to a capital key.¹⁰³

The fourth argument is that Article 5 of the Decision 2015/774, provides two limits on the purchases, therefore AG believes it provides a safeguard to prevent certainty, that the bonds will be purchased on the secondary markets. Firstly, by allowing purchases of bonds by the ESCB that do not exceed 33% from a single issue. The second limit precludes the ESCB from holding more than 33% of bonds from a single issuer during the whole duration of the PSPP. The safeguard factor comes in play in two circumstances, firstly- once the limit of 33% is achieved there will be no additional purchases and secondly- those limits are not obligations to buy that 33% amount, therefore contributing to the uncertainty.¹⁰⁴

Further talking about safeguards, AG explains that the lack of certainty about the embargo period contributes to the effectiveness of it. The GCC asked whether there is a possibility of a Courts review regarding the embargo period, Wathelet has not answered that question directly. AG rather explains that the ESCBs risk management committee has higher expertise than the Court, to determine whether the price has formed accordingly or not. Secondly, once the Court would have reviewed the embargo period, it would contribute to expectations of market operators and therefore undermine the formation of a proper price.¹⁰⁵ The second subquestion by the GCC asks whether the information provided by the ECB creates a defacto certainty that the bonds will be purchased. Head of the Legal Department of the German Central Bank, has expressed on the 10th of July hearing, that there is some predictability on the purchases of the ESCB, in particular, because one-third of government bonds can be purchased, but that does not play a role in the microeconomic level.¹⁰⁶ At the same hearing, the ECB explained that the weekly report published on its website, must be plentiful to explain the macroeconomic situation, namely which securities the ECB holds, but not the actual microeconomic practice of how, or when, they are purchased.

AG Wathelet concludes, that the aforementioned safeguards seem sufficient to ensure that the PSPP does not have an effect equivalent to direct purchases with regards to the degree

¹⁰³ DECISION (EU) 2015/774 OF THE EUROPEAN CENTRAL BANK of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10), Article 6(2).

¹⁰⁴ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 58.

¹⁰⁵ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 60.

¹⁰⁶ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 63.

of certainty that particular bonds would be purchased.¹⁰⁷ I partially agree with this argumentation. The argument that does not make so much sense is the statement that the PSPP is subsidiary in its relation to the other QE programmes, which is not true at all with relation to its volume. The second argument whose strength I doubt is the fact that purchases under the PSPP are allocated according to the capital key, that each Member State has to pay according to the size of the population and GDP.¹⁰⁸ It is true, but I do not believe that it acts as a sufficient safeguard to prevent a breach of the Article 123 TFEU, since the incremental size of all the capital keys amount to ~7.5 billion Euros, whereas the whole volume of the PSPP exceeds 2 trillion Euros.¹⁰⁹ The other arguments make sense in relation to the first 3 subquestions asked.

2.5.2 The holding of bonds until maturity

In the Gauweiler Case, the ECB particularly rejected GCCs statement that bonds would be held to maturity since the OMTs only allowed bonds with maturities from 1 to 3 years. It particularly rejected the statement by the GCC, by saying that there is nothing in the press release, that would indicate that the bonds would be held to maturity, the GCC particularly took this to heart and included this clause in its constitutional judgement. Therefore, strong was the GCCs dissent, when the PSPP increased the scope to bonds with maturities from 1 to 30 years, as well as holding part of these securities to maturity. As always in these 2 Cases, the CJEU explains that such widening contributes to the programme being more unpredictable.¹¹⁰ Therefore ensuring that the purchases do not amount to measures that would be equivalent to a credit facility from the ESCB to the Member States. The CJEU argues that such bond holding is not precluded by the Article 18.1 of the Protocol on the ESCB and ECB. CJEU further argues that the absence of an obligation to sell bonds is not sufficient to cause a breach. Firstly, the ECB can sell the bonds at any time. Secondly, if ECB holds the bonds until maturity it would not diminish the impetus for the Member States to follow sound policies.¹¹¹

¹⁰⁷ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 65.

¹⁰⁸ ECB, “*Capital Subscription*”, accessed on: www.ecb.europa.eu/ecb/orga/capital/html/index.en.html.

¹⁰⁹ Ibid.

¹¹⁰ Opinion of 4 October 2018, Advocate General Wathelet, C-493/17, ECLI:EU:C:2018:815, paragraph 69.

¹¹¹ Judgment of the 11 December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 150-151.

2.5.3 The CJEU judgement in Weiss Case, sufficient safeguards doctrine and future development

The CJEU begins speaking about the issues related to Article 123 TFEU, starting from paragraph 101. The CJEU has relied heavily on the Pringle and Gauweiler doctrines to justify the PSPP in the Weiss Case. However, as mentioned in the AGs opinion, the Court has used the additional limits set by the ECB to justify the PSPP in this Case. The length of bond maturity that has been increased in the PSPP, has seemingly been countered by the sufficient safeguards doctrine, which entails the 2 limits. Firstly- the purchases can not amount to a measure that would be equivalent to the purchases on the primary markets.¹¹² And secondly, sufficient safeguards should be built in the programme to prevent the breach and prevent the situation, where Member States impetus to follow sound public finances is disturbed by the APP programmes.¹¹³ Therefore, sufficient safeguards have been updated to include clauses that prevent the ESCB from holding more than 33% of bonds from one issue, and secondly prohibits holding more than 33% of bonds from one issuer at any time. CJEU expresses that the general safeguards that must be in place, to observe the 2 limits, will depend on the particular features of the programme and economic context in which the programme is implemented.¹¹⁴

Therefore, this statement given by the CJEU adds to the doctrine set around Article 123 TFEU and attaches continuity to it. If another programme is going to be implemented in the future, then the sufficient safeguards set by the ECB will be again examined in the light of the particular features of the programme and in the context of the economic situation. The CJEU lastly adds that such a review of whether the safeguards are sufficient will be made in the event that the programme gets challenged again.¹¹⁵ Thus, the Court partly steers the doctrine in the direction of the case by case basis. However, it can be argued that those are only the sufficient safeguards, that must be reviewed in each case separately, whilst at the same time, the CJEU has used doctrine and Article 123 interpretation from the Gauweiler Case as binding case law.

In summary- these APP programmes are intended to walk a fine line, on the one side-

¹¹² Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 106.

¹¹³ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 106.

¹¹⁴ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 108.

¹¹⁵ Ibid.

giving trust to the Eurozones macro bond system by purchasing some of the bonds and at the same time- the presence of the ESCB in the markets must not be such- to cause a certainty amongst the market players- that certain bonds will be rebought by the ESCB.

2.5.4 Addressing the concern that intervention through PSPP is equivalent to intervention in the primary markets

The GCC believed, that the PSPP may create de facto certainty among investors, that the bonds would be repurchased in the secondary markets.¹¹⁶ The CJEU explains, that the ECB has put in place various safeguards (again), to ensure that private investors are not able to act as middlemen for the ESCB.¹¹⁷ The CJEU further examines the safeguards explained in the AGs opinion.

CJEU explains that ECBs intervention would be incompatible with Article 123 TFEU if the market participant would know for a fact that the ECB will purchase the particular bonds, but there are many factors that prevent such certainty. Firstly- the blackout period, which the ECB itself monitors, to ensure that bonds are not purchased immediately after their issuance, the blackout period is measured in days rather than weeks.¹¹⁸ Purchases can just as well take place after months or even years after issue, so there is uncertainty.

The ECB does disclose the projected volume for a given month of purchases under the APP. The CJEU applies a similar rationale as in the AGs opinion and explains that the volume set out applies to the whole of APP and that PSPP purchases make up only a residual amount.¹¹⁹ In fact, this argument is flawed since the PSPP constitutes to the most of purchases made under the APP. The fact, that the ECB might as well buy nothing in the given month if it chooses to do so, contributes to the uncertainty amongst investors.

Secondly, the purchases are to be distributed according to the capital key, even though again- the ECB can deviate from these rules and for example- purchase none. The fact that the securities are widely diversified- bonds with all kinds of maturities, it makes it extremely hard for investors to know which particular ones will be purchased.

¹¹⁶ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 109.

¹¹⁷ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 113.

¹¹⁸ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 115.

¹¹⁹ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 119 .

Lastly, the CJEU explains that in fact if there were a shortage of bonds, which ECB strongly disputes, then there are still sufficient safeguards to prevent the investors from having certainty over which securities will be bought. As mentioned in the AG Wathelets opinion paragraph 79, the PSPP allows to see the macro picture- that bonds will be purchased, but the micro picture is not visible for the investors and does not give any certainty to them.¹²⁰

According to the 2.5.3 subchapter, we can see how the CJEU has examined whether the safeguards are sufficient in this particular case. Following from the CJEU's judgment the ECB has enacted sufficient safeguards to prevent the investors from having certainty regarding this particular programme. Therefore intervention through PSPP is not equivalent to intervention in the primary markets.

2.5.5 Possibly reduced impetus to conduct sound budgetary policy

The GCC asked whether the Decision 2015/774 is compatible with Article 123(1) TFEU. GCC believed that the certainty created regarding ESCB's intervention may distort the medium to long term budget situation by damaging the Member State impetus to follow a sound monetary policy. To answer this question, the CJEU has again relied on the Gauweiler doctrine. Firstly, the CJEU refers to the Gauweiler Case paragraphs 108 and 110, which explain that the implementation of the PSPP facilitates the financing for the Member States to a certain extent, but that is not decisive to reduce the impetus to follow sound budget policies. Paragraph 110, explains that the conduct of monetary policy will always entail an effect on the interest rates and therefore influencing the public deficit of Member States.¹²¹ But that does not mean the PSPP is incompatible with Article 123 TFEU.¹²² However, to avoid the situation where the impetus to pursue a sound budgetary policy is diminished, there is the recital 7 of the decision 2015/774, which states that the PSPP will only be implemented until the Governing Council sees a sustained path in the development of the inflation. The concept of conditionality is transposed from the Gauweiler Case to this one, by the means of analogy. The ECB reserves the right to sell

¹²⁰ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 128.

¹²¹ Judgment of 16 June 2015, Peter Gauweiler and Others v Deutscher Bundestag, C-62/14, ECLI:EU:C:2015:400, paragraph 110.

¹²² Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 131.

the bonds at any time, thereafter ECB can respond towards changing attitudes of Member States. If the Member States were to adopt loose policies, the ECB can turn away from them at any time.¹²³ The Decision 2015/774, Article 3(2) lays down strict qualification criteria which are based on the credit rating assessment. The AG has stated in his opinion, that the Member States can not rely on the PSPP to abandon sound monetary policies since the bonds risk being downgraded and excluded from the PSPP or the ESCB might as well sell all of them. The CJEU holds that the Decision 2015/774 does not reduce the impetus to follow a sound budgetary policy.¹²⁴

2.6 Deduction from the case law reasoning (conclusions-tailor it to answer the research question)

Both of the Cases analyzed are of vital importance regarding the ECB's mandate. The first OMT Case arose at a time when investors were doubting the future of the Eurozone. And since the OMT was never implemented, the following PSPP programme got implemented and challenged by the GCC again. It can be noticed, that the questions asked in the second Case are built on the answers given in the first Case. For example, the GCC asked in Gauweiler- if there would be no quantitative limits on the programme, and in Weiss Case, there is a question that asks, whether the purchases are communicated in a way to create a certainty amongst market operators. The Court answered the questions in the Gauweiler, that there should be no certainty among market operators, only then the programme can be lawful. So, the GCC does not ask about the quantitative limits anymore but rather aims to challenge the answers given in the previous Case. In Gauweiler, the GCC asked, of the time gap between a sale on primary markets and purchases on the secondary markets, so the market price would be allowed to form. However, in the Weiss Case, the GCC explains that there have not been given any details about the embargo period and whether there is Court review possible in that regard.

In a similar way, the sufficient safeguards doctrine has been developed, with it first being mentioned in the AG's Villalons opinion, with later finalization of it a couple of years later in the Weiss Case. So we can see, the doctrine of the APP legality developing in nuances,

¹²³ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 135.

¹²⁴ Judgment of the 11th December of 2018, Heinrich Weiss and Others, C-493/17, ECLI:EU:C:2018:1000, paragraph 144.

thanks to the new case law.

2.6.1 Interpretation of Article 123 conducted by the CJEU and scholars

The CJEU has firstly loosened the strictness of Article 123 via the analogy explained in the Pringle Case. This doctrine transposes the less strict meaning of Article 125 TFEU to Article 123. When assessing the interpretation from the historic and teleological perspective, the initial notes of the Maastricht Treaty draft explicitly state, that purchases on the secondary markets should not be used to circumvent the prohibition in the Article 123 TFEU. Authors of the Treaty thought that Articles 123 and 125 would prevent the Member States from conducting unsound budgetary policies, but they did not plan for the failure of this mechanism. Resulting from the failure of the mechanism, an additional stress was put on the Article 123, since when the mechanism fails, the Member States need financial support which is prohibited according to the Article 123. The CJEU had to deal with the additional stress in the legislative system by developing a new doctrine, which would allow the QE, at the same time ensuring it would not breach the Treaty.

2.6.2 General Rule and alterations made to it by the Courts practice

The general rule is, in other words, the literal interpretation of Article 123 TFEU. However, it is known that the CJEU uses various interpretation methods side by side in its practice, but the literal method is usually the first one since the interpreter has to understand first- what the provision talks about from the grammatical perspective. The grammatical interpretation gives a clear answer, in this case, there can be no credit facilities within the ESCB for the benefit of Member States, they are prohibited. Which means, that there can be no Member State bond purchases conducted by the ESCB whatsoever. Since bonds are debt instruments, and such action would result in a credit balance for the States. However, by both of the Cases analyzed, the CJEU has implemented other interpretation methods to ultimately adjust the legality of the APP's and consider them legal. The aim of this research was to unravel and explain those methods and examine how such departure of the grammatically interpreted rule can be justified.

Sufficient safeguards doctrine has been the result of the interpretation made by the CJEU and AG's, permitting the purchases made on the secondary markets by the ESCB. This has been the solution developed by AG's and the CJEU. The Sufficient safeguards doctrine has

2 legs. First one, the ESCB does not have the authority to conduct purchases where its action would have an equivalent effect to the purchases on the primary markets. The second one prevents the government bond purchases to be of such nature to lessen the impetus of the Member States to follow sound budgetary policy. Thus, whenever the CJEU assesses whether the sufficient safeguards are sufficient, it has to look at each of the legs as overarching principles, which cannot be violated under any circumstances. These two principles are constants, they cannot change, the safeguards themselves built in the programmes are the variables, which can change from programme to programme and should be examined according to the case by case basis if such review is requested. Deriving from the Case analysis, it can be concluded that the safeguards, in both instances have been sufficient to prevent a breach of the Treaty.

3. WHAT LEGAL FRAMEWORKS ARE IN PRACTICE IN THE UNITED STATES AND JAPAN COMPARED TO THE EUROPEAN UNION?

3.1.1 Comparison of the different legal frameworks

Responses to the crisis by the central banks have been different for various reasons. Firstly, the EU was trying to resolve the sovereign debt crisis, whereas the FED and BoE were addressing the subprime lending crisis in the banking sector. The Bank of Japan is the veteran of QE since it was the first one to implement these policies in the early 2000s.¹²⁵ It is important to note, that the EU's situation is more delicate since the monetary union is composed of 19 countries¹²⁶ and each of those countries oversees their fiscal and economic policy independently. Whereas, when we assess Japan's central bank or FED, they are only responsible for a single country.

Federal Reserve, for instance, has dual policy objectives, which entail stable inflation and maximum possible employment.¹²⁷ Section 14 of the Federal Reserve Act, provides that any Federal Reserve bank can, under regulations and rules set by the Board of Governors

¹²⁵ Konstantinos Voutsinas and Richard A. Werner, "New Evidence on the Effectiveness of 'Quantitative Easing' in Japan", *Centre for Banking, Finance and Sustainable Development, School of Management, University of Southampton*, 2010.

¹²⁶ European Union, "The Euro", accessed on: europa.eu/european-union/about-eu/euro_en.

¹²⁷ Federal Reserve Act, Section 2A. Monetary policy objectives, November 16th 1977, accessed on: www.federalreserve.gov/aboutthefed/section2a.htm.

of the FED, purchase or sell in the open market, securities of foreign or domestic banks.¹²⁸ Thereinafter the Act that establishes the FED already provided in 1913, that the nations central bank can purchase government bonds. However, similarly to the ECB, the FED does not conduct purchases on the primary markets. Bonds are first purchased by authorized agents, and afterwards, the FED can repurchase them on the secondary markets.¹²⁹

BoE has two purposes as well: monetary stability and financial stability, BoE should reduce the risks to the markets by targeted financial operations, involving the lender of last resort to maintain financial stability.¹³⁰ BoE purchases the bonds on the secondary markets from investors like insurance companies and pension funds.¹³¹ Therefore its practice is not fundamentally different from others.

Regarding the mandate, the ECB and Bank of Japan are only responsible for the price stability.¹³² The difference with the BoJ comes, regarding its bonds purchases, for the most part, the bonds get purchased by private players, that are eligible according to the BoJ's criteria.¹³³ The BoJ should not lend money according to Article 5 of Japanese Public Finance law, but the same Article prescribes a special circumstances clause. This clause allows the BoJ to lend money to the government within the amount approved by the Diet,¹³⁴ which is the Japanese Parliament. When comparing with the practices of other Central banks, the BoJ's system is quite similar, because the bank usually purchases the bonds from institutional investors on the secondary markets. And the purchases by private actors on the primary markets are conducted according to strict auction rules.¹³⁵

It can be concluded that the mandates of all the major Central Banks include the main objective of price stability. The FED, BoE has a dual mandate, whereas the BoJ and ECB have only one main objective of monetary policy. All the banks practice purchases on the

¹²⁸ Federal Reserve act, Section 14. Open Market Operations, December 23rd 1913, accessed on: legcounsel.house.gov/Comps/Federal%20Reserve%20Act.pdf.

¹²⁹ Board of Governors of the Federal Reserve System, accessed on: www.federalreserve.gov/faqs/how-does-the-federal-reserve-buying-and-selling-of-securities-relate-to-the-borrowing-decisions-of-the-federal-government.htm.

¹³⁰ Guillermo de la Dehesa, "Monetary Policy Responses to the Crisis by ECB, FED and BoE", *Directorate General For Internal Policies Policy Department A: Economic And Scientific Policy*, 2012, accessed on: www.europarl.europa.eu/document/activities/cont/201208/20120820ATT49767/20120820ATT49767EN.pdf.

¹³¹ Bank of England, "Frequently Asked Questions", accessed on: www.bankofengland.co.uk/faq#anchor_1516787825518.

¹³² Bank of Japan, Act No. 89 of 1997, "The principle of Currency and Economic control".

¹³³ The Bank of Japan, "Principal Terms and Conditions for the Outright Purchase/Sale of Japanese Government Bonds", accessed on: www.boj.or.jp/en/mopo/measures/term_cond/yoryo06.htm/.

¹³⁴ Japanese Public Finance Law, Law No. 34, Apr. 31, 1947, accessed on: www.mof.go.jp/english/budget/budget/fy2002/brief/2002-35.htm.

¹³⁵ Ibid.

secondary markets, with the exception of the BoJ which has the option to intervene in the primary markets, if permitted by the parliament. For the most part, the Central Bank practices are similar to the ECB. The main difference comes in the fact that the ECBs policies have been actively challenged in the Court two times. Which has resulted in a clear doctrine regarding the purchases of government bonds. Other central banks have not experienced such challenges and it can be attributed to the fact that they are solely responsible for one country. Whereas the ECB is responsible for the whole monetary union and therein lies higher probability, that ECBs actions will be challenged if one of the members is not satisfied. The ECB has had to find a way around the Treaty to realise QE and even then, they had to fight two consequent legal challenges, which set a strong legal framework for the next time the QE is needed in the form of sovereign bond purchases.

4. CONCLUSIONS

Following the economic downturn of 2008, in 2011 a sovereign debt crisis broke out in the Eurozone. Causing distress amongst investors and pushing the bond spreads in opposite directions between the centre and the periphery of Europe. The usual method of lowering the interest rates was not mitigating the situation, therefore APP's got implemented. These programmes have resulted in 2 outcomes. First one is narrower bonds spreads, therefore the Member States with high debt levels were able to manage their liabilities and enhance their financial situation. On the other hand, this facilitation of financing has further contributed to the debt problem, particularly in the PIGS countries and Greece. The overall amount of 2.7 trillion Euros purchased through the PSPP is reasonable, considering that the annual EU GDP is 19 trillion USD. The PSPP has been in the reinvestment stage since 2018, thus inactive. It is concluded that the APPs work best at times of economic downturn, since the Keynesian multiplier value increases. Therefore it is good that the PSPP has been put to halt. Increased use of APPs to finance large public projects has been proposed by the advocates of the MMT. But the giants of finance in the US have condemned these ideas and labelled them as dangerous. Their disapproval has been validated by the research that showcases the effects of the implementation of such policies-inflationary spirals and market anomalies leading to a financial crisis. Therefore, the author holds to the view, that such radical policies should not be implemented, and the asset purchase programmes we have had in the EU are reasonable. The fact that the PSPP is inactive, proves that ECBs monetary stimulus instrument is not exhausted at the moment,

thus it will be more impactful when the next downturn comes. This readiness is ever so important in the business cycle stage we are right now. We have not seen a contraction for 10 years and the cycle usually turns downwards after 6-9 years of a bull run. This in conjunction with the flattening yield curve in the US and the strong technical resistance around the 2900 point region of the S&P500 index, signals a possible downturn in the medium term.

The authors of the Maastricht Treaty did not plan for the failure of the prevention mechanism created by Articles 123 and 125 TFEU. Both of them were intended to prevent the Member States from following unsound public finances. It failed, some Member States like PIGS amassed excessive government debts, therefore threatening the existence of the Eurozone. The European bureaucracy had to deal with the failure of this mechanism and it did, by implementing the OMT and PSPP. But in fact, these programmes violated Article 123 TFEU, if the grammatical interpretation is followed. CJEU uses many interpretation methods. So, the one used in this case is an analogy, the court transposed the less strict meaning of Article 125 TFEU to Article 123, therefore making it less strict as well. The CJEU has interpreted that the slightly looser attitude towards monetary assistance in Article 125 might support the view that such assistance is permitted and lawful, even under Article 123, in certain conditions.¹³⁶ In *Gauweiler*, the CJEU referred to the *Pringle* Case when answering one of the questions, by stating that the ESCB is not allowed to purchase bonds on the primary markets, but the purchases on the secondary markets are not prohibited. Court uses a systemic interpretation by complementing Article 123 TFEU with Article 18.1 of the Protocol on ECB, which states that in order to achieve the price stability it can purchase bonds.¹³⁷ The CJEU further retracted by setting the first leg of the sufficient safeguard doctrine which is that the ESCB does not have the mandate to conduct purchases of Member State bonds under circumstances, which would mean that its actions carry equivalent consequences to the purchases made on the primary markets. Maastricht Treaty draft provides a comment, that the purchases on the secondary markets must not be used to circumvent the meaning of Article 123 and as explained earlier this system had failed. Therefore, the CJEU had to deal with additional stress in the legislative system and that lead the CJEU to develop the sufficient safeguards doctrine. It was first mentioned in the AG's *Cruz Villalon*, where he expressed that the purchases of bonds by the ESCB on any markets are prohibited by the Treaty in case they circumvent the meaning in the

¹³⁶ Supra note, page 22, the *Pringle* doctrine.

¹³⁷ Supra note. Page 24.

Article 123 TFEU. Therefore bonds could only be purchased on the secondary markets and strong safeguards should be built in the programmes to ensure that they do not circumvent the meaning of the 123 TFEU. After Gauweiler, the main requirement in sufficient safeguards instruction is that the market price should be allowed to form before any purchases are undertaken. The second leg of the sufficient safeguards doctrine prevents the bond purchases to be of such nature to lessen the impetus for the Member States to follow a sound budgetary policy.

The Weiss Case confirmed the doctrine set by the Gauweiler Case. CJEU referred to Gauweiler to answer the question asked in the preliminary ruling. Legal scholars note that the request for the preliminary ruling in Weiss Case was made in much more delicate manner than in Gauweiler, and the GCC has even allowed the CJEU to build upon the sufficient safeguards doctrine by asking questions that are aimed at both legs of the sufficient safeguards. The variables of the sufficient safeguards doctrine are the exact safeguards that are set upon the APPs to not breach one or both of the leg principles or limits. And the CJEU has got the chance to explain its positions on each of the limits with respect to the principles of the doctrine. Such limits include embargo period, 33% issue purchase limit and communication of the ECB in such a way to not reveal the microeconomic plans of the purchases and therefore avoid creating certainty amongst market participants. The Weiss Case attached continuity to the sufficient safeguards doctrine, by stating that the general safeguards that must be in place, to observe the 2 legs of the doctrine, will depend on the particular features and the economic environment at the time of the implementation of the programme. Courts further notes, that such a review of those safeguards would only be possible in the case of a preliminary request. And this identifies a path for future research, once economic momentum will turn downwards, the ECB will probably have to intervene again through programmes similar to the PSPP. And therein lies the possibility to examine the further development of the sufficient safeguards doctrine if a preliminary ruling will be requested. As well as analysis can be conducted, of whether those safeguards are sufficient to prevent the breach of the leg principles.

Clarification of the sufficient safeguards doctrine has been of vital importance. If the ECB was concerned before the judgment of Gauweiler, then after the Weiss Case, the ECB clearly knows its limits and procedure regarding the legality of QE programmes. This clarification can help the ECB to make fast and precise decisions with confidence- when the next downturn comes. Since fast and precise reaction by the guardian of the Euro is

vital to counter unexpected contractions and mitigate them.

Regardless of the legal frameworks that other Central Banks operate in, it can be concluded that every one of them is pursuing the main objective of price stability. Some banks like the FED and BoE have dual mandates, whereas the ECB and BoJ have a single objective. It is the general practice for the bonds to be purchased on the secondary markets, once the market price has formed. Although, with the exception of Japan whose Central Bank can purchase bonds on the primary markets if permitted by the Parliament. The main difference comes in the fact that all the other Central Banks are responsible for only one country, whereas the ECB is responsible for 19. That increases the probability that there will be legal challenges thrown in its way. And thanks to these challenges, the legal framework the ECB operates in now, is stable.

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